No. 80-929

ALEXANDER L

In the Supreme Court of the United States

OCTOBER TERM, 1980

SOL NEIL CORBIN, PETITIONER

v.

FEDERAL RESERVE BANK OF NEW YORK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether rules concerning post-insolvency interest claims under the Bankruptcy Act apply to agreements negotiated by the Federal Deposit Insurance Corporation to facilitate prompt third-party purchase of the assets and assumption of the liabilities of insolvent national banks.

2. Whether the interest provisions of an agreement entered into between the Federal Deposit Insurance Corporation and the Federal Reserve Bank of New York, under which the Federal Reserve Bank released its collateral and accepted a deferred payment schedule for its $1.7 billion debt, were reasonable and equitable.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 629 F. 2d 233. The opinions of the district court (Pet. App. 14a-21a, 22a-47a) are reported at 458 F. Supp. 143 and 475 F. Supp. 1060.

JURISDICTION

The judgment of the court of appeals was entered on July 25, 1980 (Pet. App. 48a-49a). A petition for rehearing was denied on September 9, 1980 (Pet. App. 50a-51a). The petition for a writ of certiorari was filed on December 8, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Section 13 of the Federal Deposit Insurance Act, 12 U.S.C. 1823, provides in pertinent part:

> (d) * * * The [Federal Deposit Insurance] Corporation, in its discretion, may make loans on the security of or may purchase and liquidate or sell any part of the assets of an insured bank which is now or may hereafter be closed on account of inability to meet the demands of its depositors, but in any case in which the Corporation is acting as receiver of a closed insured bank, no such loan or purchase shall be made without the approval of a court of competent jurisdiction.
>
> (e) Whenever in the judgment of the Board of Directors such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation of an insured bank with another insured bank, or will facilitate the sale of the assets of an open or closed insured bank to and assumption of its liabilities by another insured bank, the Corporation may, upon such terms and conditions as it may determine, make loans secured in whole or in part by assets of an open or closed insured bank, which

loans may be in subordination to the rights of depositors and other creditors, or the Corporation may purchase any such assets or may guarantee any other insured bank against loss by reason of its assuming the liabilities and purchasing the assets of an open or closed insured bank. Any insured national bank or District bank, or the Corporation as receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans.

STATEMENT

1. On October 8, 1974, Franklin National Bank (Franklin), a national banking association, was declared insolvent by the Comptroller of the Currency. Pursuant to statute (12 U.S.C. 191, 1821(c)), the Federal Deposit Insurance Corporation (FDIC) was appointed receiver (Pet. App. 17a, 27a). On the same day, the FDIC consummated a series of agreements in order to effectuate a "purchase and assumption" of the bank's assets and liabilities by another insured bank under Section 13 of the Federal Deposit Insurance Act, 12 U.S.C. 1823. The objective of the agreements was to minimize the impact of Franklin's failure and maximize the return on its liquidated assets. Under these agreements, European-American Bank and Trust Company assumed $1.66 billion of Franklin's liabilities and acquired $1.54 billion in unencumbered assets. This permitted Franklin's 104 banking offices to open the next day as European-American offices without further disruption (Pet. App. 17a, 28a).[1]

In order to transfer the necessary unencumbered assets to European-American and to acquire additional assets for liquidation, FDIC contemporaneously agreed to assume a

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[1]The $125 million difference between the liabilities assumed and the assets acquired represented the premium paid by European-American Bank for Franklin's ongoing business. Pet. App. 17a, 28a.

$1.7 billion secured debt (previously accruing interest at a rate of 10% per annum) owed by Franklin to the Federal Reserve Bank of New York.[2] For its part, the Reserve Bank agreed to release $2.3 billion in collateral securing that debt (Pet. App. 4a, 17a, 27a, 29a-30a). FDIC agreed to repay the $1.7 billion debt to the Reserve Bank after three years (*i.e.*, on October 7, 1977), together with simple interest of 7.52% per annum (less $15 million in liquidation expenses). The interest due was subject to escalation to 8.5% for those three years, compounded annually, in the event that the assets in liquidation generated sufficient funds to cover the increased payment obligation (*id.* at 6a, 29a-30a). Any residue would then be transferred to the Franklin receivership for the benefit of unsecured creditors and stockholders (*id.* at 17a-18a, 28a-29a).[3]

During the next three years, the FDIC liquidated a substantial amount of Franklin's retained assets. By October 7, 1977, it had paid the Reserve Bank the $1.7 billion deferred debt plus the agreed simple interest of 7.52% per annum (Pet. App. 18a, 31a).

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[2]The $1.7 billion debt resulted from the Reserve Bank's efforts to shore up Franklin National Bank during the summer of 1974 through emergency, short-term loans. See Pet. App. 4a, 16a, 26a-27a. European-American Bank was unwilling to assume a debt of this size (Pet. App. 16a-17a). The FDIC assumed the debt in its corporate capacity.

[3]The agreements entered into by the FDIC were made subject to judicial approval, as required by the National Bank Act. See Pet. App. 4a, 17a, 31a; *In re Franklin National Bank*, 381 F. Supp. 1390 (E.D.N.Y. 1974).

FDIC's agreement to repay Franklin's $1.7 billion debt to the Reserve Bank was accompanied by an arrangement whereby FDIC, in its corporate capacity, would "loan" the receivership that amount and would be repaid from retained assets of the receivership estate. Pet. App. 28a-29a.

2. Meanwhile, on October 6, 1977, petitioner (the trustee in bankruptcy of Franklin's holding corporation) brought this action against the Reserve Bank and the FDIC in the United States District Court for the Southern District of New York. Petitioner sought to modify the interest provisions of the agreement between the FDIC and the Reserve Bank (Pet. App. 18a, 23a-24a). Petitioner complained that the interest payable under the agreement would "unfairly" reduce the residual estate of the receivership (*id.* at 24a).[4]

Following a bench trial, the district court issued a decision dismissing the complaint (Pet. App. 22a-47a). The court ruled that "the October 8, 1974 transactions were legal and well within the range of reason and constituted the best results available on an overall basis" (*id.* at 47a). The court found that the FDIC did not profit at the expense of the estate, that it exercised reasonable business judgment, and that the challenged aspects of the transaction were fair and not a breach of fiduciary duty to the creditors and stockholders of Franklin (*ibid.*).[5]

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[4]The 7.52% simple interest obligation amounted to $218.9 million. While petitioner challenged that interest payment in the district court, he did not do so in the court of appeals (Pet. App. 6a).

The challenged additional payment produced by the contingent 8.5% interest obligation amounts to $60.7 million. That sum allegedly consists of (1) simple interest of $30.4 million (the difference between a 7.52% simple rate and a 8.5% simple rate on the unpaid principal of the debt from 1974 to 1977), and (2) additional interest of $30.2 million caused by compounding the 8.5% rate annually for the three years in question (Pet. 5).

[5]The court stated that "the interest rate arrangements * * * were part of a global negotiation of a series of interdependent and complex matters that were negotiated at arm's length, were agreed to in the exercise of sound judgment by the Receiver and FDIC (corporate), were fair to the receivership estate and were not a breach of fiduciary duty * * *" (Pet. App. 25a).

On appeal, petitioner asserted that the district court had given insufficient attention to this Court's decision in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946).[6] The court of appeals rejected that argument and affirmed the district court's decision in its entirety (Pet. App. 1a-13a). The court of appeals expressed doubt that *Vanston* had "any application to this case" (*id.* at 7a), explaining that "equitable principles developed in the reorganization context cannot simply be grafted onto the national banking statutes" (*id.* at 8a). In any event, the court of appeals held that "the principles enunciated in *Vanston* do not * * * suggest any impropriety in the transaction at issue here" (*id.* at 9a). The court found no "inequitable" feature in the post-insolvency interest agreement between the FDIC and the Reserve Bank (*id.* at 9a-10a), and refused to interpret *Vanston* as establishing a *per se* rule against post-insolvency interest on unpaid interest that would invalidate the agreement negotiated by the FDIC and Reserve Bank in this case (*id.* at 10a-12a). The court of appeals pointed out that here, unlike the situation presented in *Vanston*, "the delay in repayment of the secured creditor was agreed to in part to allow a purchase and assumption by European-American and in part to allow orderly liquidation of remaining assets" (*id.* at 12a).

ARGUMENT

The decision of the court of appeals that *Vanston Bondholders Protective Committee* v. *Green, supra*, is inapplicable in this case is correct and does not conflict with any decision of this Court or any other court. In any event, even if this Court were to accept petitioner's assertion that the equitable principles announced in *Vanston* apply to purchase/assumption agreements negotiated by the FDIC,

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[6]The district court's discussion of *Vanston* appears at Pet. App. 46a.

that would not change the result in this case. Both courts below determined, following a searching examination of the agreements in question and the economic context in which they were negotiated, that the agreements were in all respects fair and equitable. Further review of that factual determination is not warranted.

1. Petitioner argues (Pet. 9-28) that this Court's decision in *Vanston Bondholder's Protective Committee* v. *Green*, 329 U.S. 156 (1964), and its progeny, invalidate the interest provisions of the agreement negotiated by the FDIC in this case.[7] *Vanston*, however, arose in an unrelated context and announces no legal principle that is controlling here. *Vanston* involved a corporate reorganization proceeding under Chapter X of the Bankruptcy Act. The Court held that mortgage bondholders could not recover interest on unpaid interest pursuant to their mortgage indenture for the period after insolvency. The basis for that ruling was a district court order directing the debtor to withhold interest on all debts after the estate of the debtor came into the custody of the court. That order was intended to preserve the status quo ante for the protection of all creditors. 329 U.S. at 163. To require the payment of interest on interest after the district court entered an order forbidding such distributions would serve as a "penalty" for failure to make distributions specifically enjoined by the district court's order. Such interest payments also would amount to "added compensation" for the bondholders that would improve their position relative to the other creditors. 329 U.S. at 166. Accordingly, the Court concluded: "we think an allowance of interest on

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[7]Petitioner concedes that the question whether the *Vanston* doctrine applies to a purchase/assumption agreement negotiated by the FDIC is a question which has never been addressed by any court other than the courts below (Pet. 2, 28).

interest under the circumstances shown by this case would not be in accord with the equitable principles governing bankruptcy distributions." 329 U.S. at 163.

The situation is quite different in the case of insolvent banks. The Bankruptcy Act, construed in *Vanston*, explicitly exempts banks from its provisions. See 11 U.S.C. 22; 11 U.S.C. (Supp. III) 109(b)(2). National bank insolvencies are dealt with under an entirely different statutory scheme, which is tailored to the particular economic role of banks in the national economy. See 12 U.S.C. 191 *et seq.*; 12 U.S.C. 1811 *et seq.*[8] In this context, an agreement negotiated by the FDIC and approved by the district court for the purpose of preserving the economic viability of an insolvent bank cannot be compared to a private indenture serving the interests of one group of creditors seeking to advance their position relative to that of other creditors. In negotiating such an agreement, the FDIC undertakes to protect "the interests of creditors, its own welfare, and that of the economy as a whole" (Pet. App. 5a n.1).

In the event of a bank insolvency, continuation of the insolvent bank's business by another bank, preservation of federal deposit insurance funds, and avoidance of the economic effects resulting from a freeze on deposits, are factors that must be weighed along with the "balance of equities between creditor and creditor or between creditors and the debtor" (*Vanston Bondholders Protective Committee* v. *Green, supra*, 329 U.S. at 165). To assure the proper consideration of all of these factors, Congress mandated that national bank insolvencies should be administered by a

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[8]"Congress has established a complete system for the administration and liquidation of insolvent national banks * * *." *FDIC* v. *Grella*, 553 F. 2d 258, 261 (2d Cir. 1977).

government agency (the FDIC)—not a district court applying principles evolved in bankruptcy cases.[9]

Under the Federal Deposit Insurance Act, 12 U.S.C. 1823(e), Congress has vested the FDIC with broad authority to negotiate agreements concerning the assets of insolvent banks "upon such terms and conditions as it may determine." It may enter into such agreements whenever, in its judgment, such action "will facilitate the sale of the assets of [a] * * * closed insured bank to and assumption of its liabilities by another insured bank * * *." Such transactions must be concluded promptly to assure the continuing availability of deposits and preserve the confidence of depositors.

In order to consummate agreements of this kind, the FDIC requires flexible authority to transfer unencumbered assets of the insolvent bank to the acquiring bank, within hours of the insolvency, in an amount equal to the deposit liabilities assumed (less the amount of the premium bid). This requires the FDIC to negotiate releases of collateral from secured creditors. A negotiated release of collateral would entail either an outright immediate payment to the creditor, or, where the debt is unusually large, an assumption of the debt by the FDIC on a deferred payment basis with a provision for interest. Interest payments involve several options—fixed simple interest (payable periodically

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[9]In empowering the Federal Reserve System to act as the lender of last resort, the FDIC to act as insurer and receiver, and the Comptroller of the Currency to administer national banks and determine their solvency, Congress manifested special solicitude for the banking industry. In the banking context, a system of trustees, referees and judges whose concerns are limited to resolving contests between creditors and owners of a financially distressed business would not be appropriate. Congress has prescribed a system of supervision and receivership that is capable of balancing the interests of all segments of the economy that are affected by bank insolvencies.

or on a deferred basis), compound deferred interest, floating market rate interest, interest pegged to the proceeds of the liquidation, or a combination of these methods of computation.

There is no logical reason for limiting the FDIC to any one method of interest computation. Depriving the FDIC of flexibility in negotiating interest obligations would only minimize its ability to achieve a prompt release of collateral, which is essential in arranging a purchase/assumption by a third-party bank. The FDIC must pursue such negotiations, for no secured creditor of an insolvent national bank is bound to release its collateral prior to payment of its debt.[10] Moreover, no beneficial purpose would be served by limiting the FDIC to the one form of interest computation preferred by petitioner (deferred simple interest payable without compounding). If that were the rule, the parties could agree upon whatever reasonable simple interest yield they desired, raising, for example, the simple interest yield to an amount equivalent to the yield produced by compounding.[11]

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[10]See *Ticonic National Bank* v. *Sprague*, 303 U.S. 406, 413 (1938): "[A] secured creditor of a national bank in receivership may enforce his lien against his security, where it is sufficient to cover both principal and interest, until his claim for both is satisfied." The Court held in *Ticonic* that a secured creditor, even one holding a non-interest bearing claim, is entitled to recover post-insolvency interest from his collateral. The FDIC has no power to prevent actions by secured creditors to enforce their security interests, and it is in no position to utilize litigation in lieu of negotiation in order to effectuate prompt purchase/assumption transactions.

[11]Furthermore, subjecting reasonable agreements entered into by the FDIC to hindsight review under bankruptcy law principles could chill the willingness of third-party banks to enter into such agreements. The decisions of this Court have recognized that bankruptcy rules do not necessarily govern in bank insolvencies. See *American Surety Co.* v. *Bethlehem Bank*, 314 U.S. 314, 319 n.1 (1941). See also *National Bank* v. *Mechanics' National Bank*, 94 U.S. 437, 440-441 (1876) (approving compound interest in a bank insolvency proceeding).

For these reasons, the court of appeals correctly concluded that the rule of *Vanston* and its progeny is inapplicable to post-insolvency agreements negotiated by the FDIC to effectuate purchase/assumption transactions for insolvent banks. In light of the fundamental differences between corporate reorganizations and bank insolvencies administered by the FDIC, rules developed in the bankruptcy context cannot "simply be grafted" onto FDIC purchase/assumption agreements (Pet. App. 8a).

2. Assuming arguendo that purchase/assumption transactions should be judicially reviewable after the fact in light of the "balance of equities between creditor and creditor" (*Vanston Bondholders Protective Committee* v. *Green, supra*, 329 U.S. at 165), both lower courts correctly found that there was no inequity in this case. As the court of appeals noted (Pet. App. 12a), the agreements arranged by the FDIC "did not result in a deterioration in the position of * * * subordinate creditors from the date of insolvency onward."

The New York Federal Reserve Bank held $1.7 billion in secured short-term debt of Franklin National Bank that was drawing interest of 10% per annum. Pet. App. 27a. As of the date of insolvency, the Reserve Bank had a right to obtain payment of this debt through sale of the $2.3 billion of Franklin assets that it held as security. *Ticonic National Bank* v. *Sprague, supra*, 303 U.S. at 413. In lieu of doing this, the Reserve Bank agreed to release all of its collateral and to defer payment of the debt for three years, with simple interest of 7.52% per annum, subject to escalation to 8.5% during these three years, compounded annually, in the event that the assets in liquidation produced sufficient additional proceeds for that purpose. Pet. App. 29a-30a. The simple interest accruing during the three year period was

payable at the end of the three year period, rather than semi-annually. Furthermore, any postponement in the payment of the agreed contingent interest after October 7, 1977, occasioned by continuing delay in liquidation of the assets, would reduce the effective yield below the contingent 8.5% rate (see Pet. App. 38a). Neither the FDIC nor the Federal Reserve Bank when they negotiated these arrangements had a firm basis upon which to predict the exact amount of gross proceeds to be realized from liquidation of the retained assets, the likelihood of the agreed contingent interest rate's becoming effective, or the likelihood of generation of surplus proceeds for the receivership. They negotiated what they believed to be fair and reasonable terms under all the circumstances known to them at the time.

The district court and the court of appeals found that, under these circumstances, the interest rate negotiated by the FDIC and Reserve Bank was equitable and reasonable (Pet. App. 33a-44a, 9a-10a). As the court of appeals explained (*id.* at 9a):

> [I]t was not inequitable for the FDIC to accept a plan for the repayment of FRB's indebtedness that included payments of post-insolvency interest. FRB's lien, prior to its release, exceeded the amount of the principal and interest owed under the later agreement with the FDIC. Absent such an agreement, FRB could have taken possession of the $2.2 billion worth of assets securing its loans—preventing the purchase and assumption by European-American and the resulting premium benefiting FNB--or demand under *Ticonic* post-insolvency interest if such a foreclosure were somehow delayed. * * * Based on FRB's existing rights and the options available to the FDIC at the time, we cannot say that it was inequitable to require the FNB estate to make interest payments at the rate of

> 8.5% compounded annually for the three years of forbearance, but with some payments deferred for the three years (until the principal was fully repaid) and the rest deferred even longer—to this day.

The court of appeals also pointed out that there was no unfairness in the chosen method for computing interest (Pet. App. 12a-13a n.5):

> The formula agreed upon to arrive at the "interest rate differential" or "recoupment provision" is not a provision for compound interest within the proper definition of the term. That the agreement used the words "compounded annually" to calculate the amount of a differential to be paid as interest is not determinative. Other features of the recoupment provision—the fact that the total amount due was to be fixed only after three years, that no further interest accumulated on the differential although the date of payment thereof was and remains today in the uncertain and distant future—remove it wholly from the ambit of agreements to compound interest on interest which have been disfavored by some courts.

The district court's analysis of the fairness of the negotiations between FDIC and the Reserve Bank (Pet. App. 33a-43a), which was adopted by the court of appeals (*id.* at 5a), further demonstrates that there is no inequity in the interest rate provision. The district court's opinion, on which we essentially rely, carefully examined the prevailing interest rates in effect, reviewed the reasons for relying on a fixed rather than a floating interest rate, computed the effect of deferral of payment in this case, and considered the economic uncertainties of the period when the FDIC and the Reserve Bank negotiated this vital agreement. The court also reviewed the benefits to the estate of Franklin National Bank resulting from the challenged agreement (*id.* at 38a):

"the FNB receivership estate has obtained as benefits of the arrangement the $125 million premium from EAB on the assets sold to it, a sale made possible by lifting of FRB's security interest in those assets, and to date another $341 million in income on collateral released by FRB-NY." In light of all of the relevant evidence, the district court found (*id.* at 43a-44a):

> the interest rate charged by FRB-NY was more than fair to the receivership estate. The rate provided in the Assumption Agreement, even if the contingent amount is fully paid, afforded a yield below the relevant market rates, the contract rates of the FNB notes (8-1/2%, later 10%), and the legal lending rate set by the New York Banking Board * * * (8-1/2%). Under all the facts and circumstances, plaintiff's claim that the FRB-NY rate was unfair falls to the ground. The plaintiff has failed to sustain a claim of unfairness with credible evidence.

In view of the concurrent factual findings of both lower courts on the fairness issue, the rule of *Graver Tank & Mfg. Co.* v. *Linde Air Products Co.*, 336 U.S. 271, 275 (1949), is fully applicable: "A court of law, such as this Court is, rather than a court for correction of errors in fact finding, cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error."

CONCLUSION

The petition for a writ of certiorari should be denied.

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